

State of Utah

Budget Summary

The state's total recommended budget is \$8.6 billion. Although these recommendations deal with the total state budget, their primary focus is on the discretionary state funds, both General Fund and school funds, totaling \$4.1 billion. Federal funds, fees, licenses, and other revenue types account for the remaining \$4.5 billion.

- General Fund - primary funding source for most state government operations and includes all revenue not accounted for in other funds. Its major revenue sources are sales taxes; insurance premium taxes; and beer, cigarette, liquor, and severance taxes.
- School funds - restricted to the support of education. Their major revenue sources are individual income and corporate franchise taxes. These funds include the Uniform School Fund.

Most states do not have a separate dedicated fund for major expenditures such as education. To compare to other states and show how the majority of Utah taxpayer money is spent, the General Fund and school funds are frequently combined in this document and are referred to as state funds.





GOVERNOR'S BUDGET OVERVIEW

GOVERNOR WALKER'S LESSONS LEARNED

Governor Walker's budget recommendations reflect the lessons she has learned through her extensive career in public service. She leaves behind a legacy of fiscal prudence and foresight. The following are the lessons she has learned, and the principles she leaves for others to follow.

Structural Balance

Each of us knows the importance of living within our means. Our ongoing revenues must match our ongoing expenditures. To protect against emergencies, it is prudent to have a savings account with sufficient savings to carry you through difficult times. While serving as a legislator, Governor Walker sponsored legislation establishing the state's savings account - the Budget Reserve Fund, commonly known as the Rainy Day Fund. Her foresight in creating this legislation helped provide an important tool used by the state to weather the recent economic downturn.

Since the recession, which began in 2001, the state has not had sufficient ongoing revenues to match its ongoing expenditures. The budget was balanced and rebalanced numerous times in general and special sessions. Ongoing program budgets were cut. In addition, current year budgets were balanced by using the Rainy Day Fund and other fund balances. Like the economy, state revenues

began slipping quickly, throwing the budget out of structural balance.

With an improving economy, Governor Walker is recommending a structurally balanced budget. The FY 2006 ongoing expenditures are funded with ongoing revenues. This structural balance provides the foundation of a sound budget.

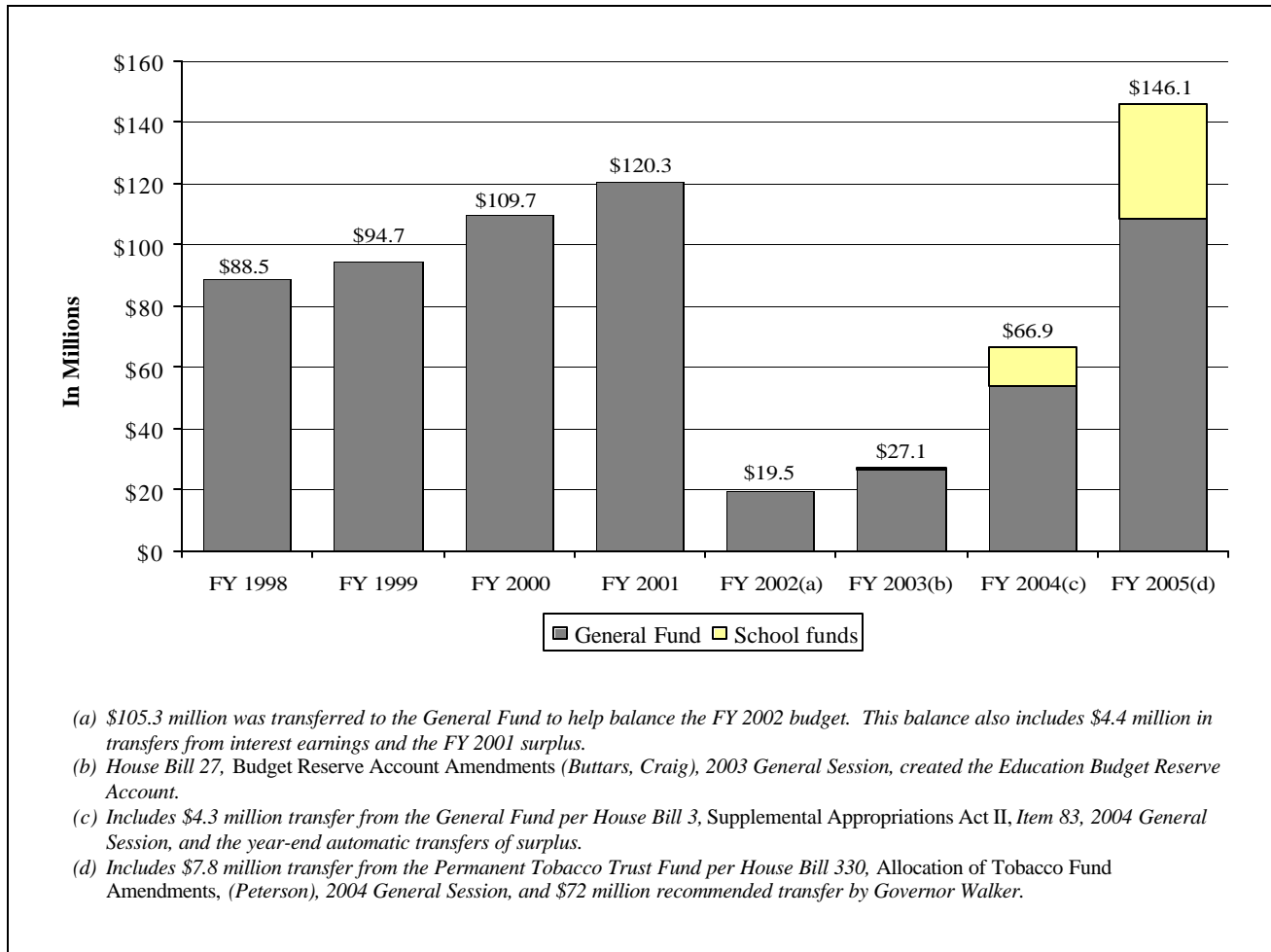
Debt Management

The State of Utah's prestigious triple A rating from the three major bond rating agencies has always served as a beacon to Governor Walker when making financial decisions. Prudent debt management is a hallmark of the state. To maintain the state's strong credit rating, Governor Walker has included three critical recommendations.

First, she recommends the use of \$100 million to pay cash for eight new state buildings. Paying cash for buildings forces the state to live within its means today while limiting the debt burden we leave for the future. Although the recent economic downturn led to greater state debt, reestablishing pay-as-you-go financing is a sound fiscal principle.

Second, the governor recommends transferring \$72 million of one-time money to the Rainy Day Fund to rebuild the fund's balance. This amount includes all of the available FY 2004 surplus as well as \$17.6 million from FY 2005. Bond rating

Figure 1
UTAH RAINY DAY FUND - HISTORIC BALANCES
 General Fund and School Funds



agencies closely monitor the unreserved and undesignated fund balances. Rebuilding these balances in advance of future economic downturns demonstrates the governor's long-term approach to decision making.

Third, Governor Walker recommends the continued short amortization of the state's debt. This shorter payoff schedule allows Utah to retire its debts in half the time, when compared to many other states. In light of the state's increasing debt levels over the past eight years, this short amortization schedule is viewed positively by the rating agencies.

No Earmarking of Revenue

Governor Walker has taken a stand against earmarking revenues. During the robust economic times of the 1990s, the state dedicated portions of its sales tax to benefit local governments. As shown in the table on page 3, two major earmarks are Class B and C road monies and capital for water loan funds. However, the governor and the legislature need maximum flexibility when developing the state's budget and establishing spending priorities. Prudent fiscal management would direct all revenues into one pot of money and force programs to compete for funding, helping to ensure that priority

programs are funded. The governor encourages the legislature not to earmark revenue sources for specific programs, but rather allow all state programs to compete for funding.

SALES TAXES

Class B and C (city and county) roads	\$17,618,000
Water development loan funds	7,175,000
Centennial Highway Fund (1/64 percent)	5,000,000
Drinking water loan fund	3,587,000
Water quality loan fund	3,587,000
Endangered Species Act	2,450,000
State park access roads	563,000
Transportation corridor revolving loan fund	563,000
Agriculture resource development	525,000
Water Rights	175,000

OTHER TAXES

Liquor tax for school lunch program	\$16,804,000
Permanent school LAND trust interest	9,577,000
Firefighters retirement premiums	9,100,000
Beer tax distribution to local govt.	4,442,000
Fire Academy support	4,413,000
Enhanced 911 phone service	3,900,000
Tobacco tax for prevention and cessation	3,382,000
	\$92,861,000

Tax Policy

When Governor Walker took office, she empaneled a group of tax advisors to propose a new tax structure for the state. She recognized that our existing tax structure would not support the necessary programs and services provided by the state in the coming years. In fact, her tax advisors discovered that the income tax base is deteriorating at 1.4 percent per year and the sales tax base is declining at 1.3 percent per year, making the need for tax reform more urgent.

In November 2004, Governor Walker proposed a bold new tax structure for the State of Utah. While others must shepherd the reform effort going forward, she has laid the foundation for a sound tax structure for the future. Her recommendations promote economic development, fairness among taxpayers, balance between state and local obligations and revenues, increased stability of the revenue stream, and a more stable structure for the 21st century. The governor's plan simplifies the tax struc-

GOVERNOR WALKER'S TAX REFORM PROPOSALS:

- Retain the traditional "three-legged stool" - income, sales, and property taxes

Income Tax

- Adopt a flat tax on individual income
 - Option 1 - based on federal taxable income
 - Option 2 - based on adjusted gross income
- Eliminate the corporate income tax

Sales Tax

- Simplify and expand the sales tax exemption for business inputs
- Broaden the base of the sales tax to include services
- Monitor the sales tax rate and lower accordingly
- Continue to participate in the Streamlined Sales Tax Project
- Simplify the local sales tax rate structure

Property Tax

- Retain the general structure of the current property tax
- Restructure water funding
- Study centrally-assessed property
- Allow school districts and other special districts to choose whether to participate in redevelopment initiatives
- Allow local entities to adjust revenues for inflation without going through Truth-in-Taxation hearings

Other Taxes

- Repeal the sales tax exemption for motor fuels and reduce the per gallon rate
- Simplify current two tiered rate on oil and gas severance and dedicate a portion of the revenues to capital projects or community or economic development
- Retain the state inheritance tax as long as there is a federal estate tax

To see the tax plan, please go to:

www.utah.gov/governor/newsrels/2004/newsrel_112204.html

ture, which makes it easier for the taxpayer and encourages compliance. The basic premise of her recommendations is to broaden the base and lower the rate.

Additionally, the state must guard its taxing capacity. When other taxing entities add optional sales taxes, they encroach on one of the state's main revenue sources and limit the state's flexibility to adjust sales tax rates in the future.

Preparing for Tomorrow

Governor Walker has prepared this budget with an eye toward tomorrow. She has learned through experience that the decisions made today not only affect us now, but also impact the future. Education will continue to be a focus, but we must not lose sight of the problems that loom just over the horizon: transportation, an aging population, and the need for water to keep our economy growing. We must maintain a long-term perspective and govern not just for today.

GOVERNOR'S BUDGET OVERVIEW

With the improvement in Utah's economy over the past year, Governor Walker is again able to recommend a balanced budget without any tax increases. During the budget process, the governor met with each state agency, the courts, public education, and higher education to review their requests and to discuss the issues driving their budgets. Her recommendations continue to reflect her support for quality public education, while maintaining vital human and public safety services.

Although the economy is much stronger, the needs still far exceed the available money. Governor Walker has focused her recommendations on building the key infrastructure of the state and its services, specifically to:

- Develop our children's basic skills in literacy and math,
- Compensate employees fairly,
- Maintain existing buildings and construct new buildings, and
- Replenish the Rainy Day Fund.

Education

K-12 October enrollment growth for the 2004-2005 school year exceeded projections by 1,582 students, reaching a total 8,744. Updated enrollment projections for school year 2005-2006 show an increase of 1,318 students over preliminary pro-

jections of 8,400, for a total of 9,718. In addition, the state faces the challenge of a growing bilingual student population. Salt Lake City and Ogden City school districts report that nearly half of their students speak English as a second language.

For FY 2005 Governor Walker has implemented a K-3 reading program in the public schools as part of Performance Plus. The goal of the program is to have all students reading at grade level by the time they leave the third grade. The governor has also launched Read with a Child, a program that encourages Utahns to read to a child at least 20 minutes a day.

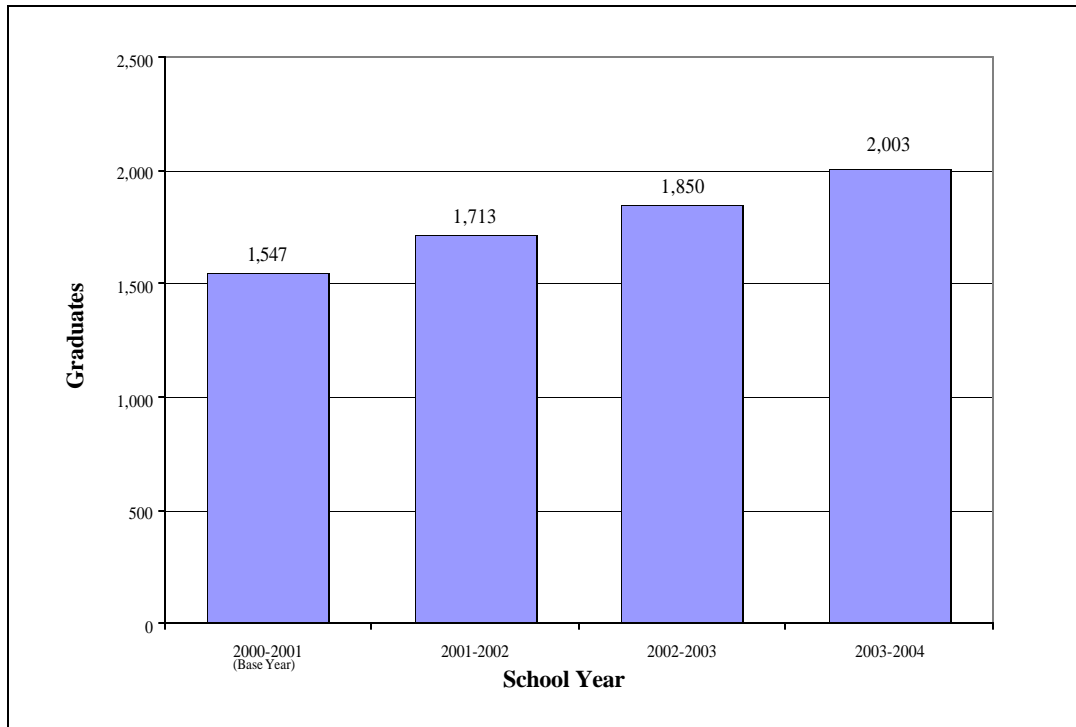
For FY 2006 the governor recommends a second phase of Performance Plus, a \$16 million math program for fourth through sixth graders with the goal of having all students performing at grade level by the time they leave the sixth grade. In addition, she recommends \$6.5 million in ongoing funds for a remedial program for tenth grade students that do not pass the Utah Basic Skills Competency Test (known as UBSCT). These programs will prove valuable in the coming years by helping students who struggle with basic skills to develop the reading and math skills necessary for them to succeed in school, and later in life.

In addition, Governor Walker recommends a 5.0 percent increase in the Weighted Pupil Unit (WPU) for salary and benefit increases for teachers.

Higher Education

Governor Walker recommends a \$3.0 million ongoing appropriation and a \$1.5 million one-time appropriation to support the engineering and nursing initiatives at the state's colleges and universities. These initiatives have proven successful in increasing the number of graduates. Figure 2 on the next page shows the increase in the number of engineering students graduating from state institutions of higher education. The governor recommends a large portion of the nursing initiative money be used to train and retain faculty to increase the state's capacity to educate new nurses.

Figure 2
ENGINEERING INITIATIVE
 Degrees Awarded by Utah Colleges and Universities



Additionally, the governor recommends that higher education receive a block grant of \$24 million for compensation. This funding will allow the colleges and universities flexibility in meeting the compensation issues they face, as well as having money to retain key faculty. Finally, Governor Walker recommends the construction of the new digital learning center at Utah Valley State College and the renovation and expansion of the Marriott Library at the University of Utah.

Human and Public Safety Services

Governor Walker is committed to maintaining state services that are basic to the health and safety of our citizens. Despite the recent improvement in Utah's economy, the state continues to face increasing costs in Medicaid (the health care program for low income individuals), food stamps, foster care, and other federal mandates.

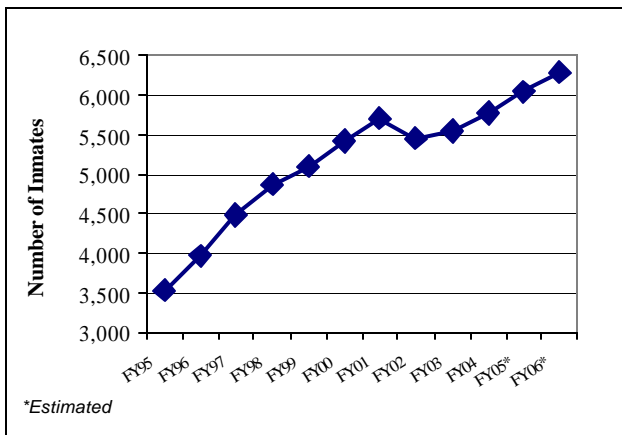
Health – The legislature appropriated funds for emergency dental care for Medicaid recipients for FY 2005. Governor Walker recommends a \$0.5 million FY 2005 supplemental to continue the program through the end of the fiscal year, as well as an ongoing appropriation of \$1.6 million to continue the program in FY 2006 and beyond. These appropriations will be matched with federal funds.

Human Services – The demand for forensic beds at the State Hospital requires the re-opening of a wing at the hospital. To meet the immediate demand for these beds, Governor Walker recommends an FY 2005 supplemental of \$1.2 million, and an ongoing appropriation of \$2.1 million for FY 2006. The state has an obligation to provide these beds in a timely manner to qualifying patients.

Corrections – The number of incarcerated inmates in Utah's prison system has reached an all-time high of 6,011 offenders. The need for additional prison beds is immediate; however, simply constructing more facilities is not an effective long-term solution to managing the state's prison population.

To meet the immediate need for beds, Governor Walker recommends an FY 2005 supplemental appropriation of \$1.7 million for jail contracting and operation of the Draper Dormitory facility. For FY 2006 the governor recommends \$4.5 million in ongoing funds for jail contracting (200 new beds) and \$4.4 million in ongoing funds and \$1.3 million in one-time funds for a full year's operation of the Draper Dormitory facility (300 beds). In addition, she is recommending the construction of a new 288 bed facility at the Central Utah Correctional Facility located in Gunnison, Utah.

Figure 3
ADULT INMATE POPULATION GROWTH
Projected 77 Percent Higher than FY 1995



To slow the growth rate of new inmates, the Commission on Criminal and Juvenile Justice has recommended adoption of the *Drug Offenders Reform Act* (DORA). DORA will increase funding to screen and assess offenders for substance abuse

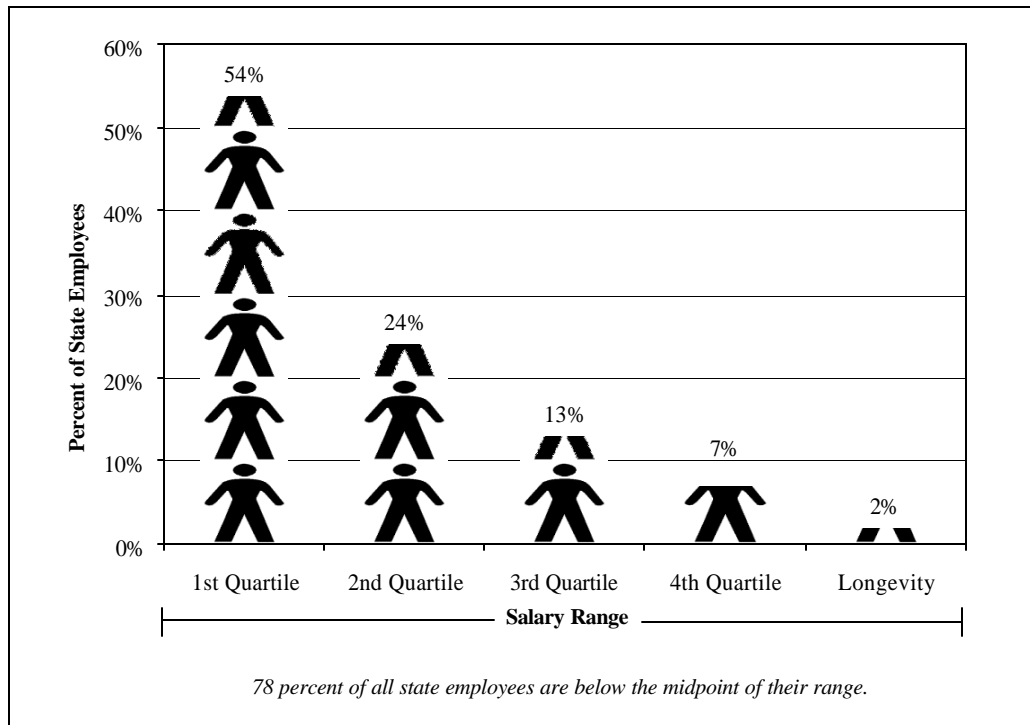


problems and then refer the offender to the proper treatment program to deal with the addiction. Substance abuse is a problem for nearly 80 percent of Utah's inmates. Similar programs have proved effective throughout the country. Governor Walker recommends \$6.3 million to fund the first phase of this program. This investment will reduce recidivism by increasing the number of inmates who have a permanent and successful reentry into society. These successful reentries should slow the growth of the state's prison population. Funding for this program will be placed within the following agencies.

- Department of Human Services - \$4,297,500
- Department of Corrections - \$1,814,700
- Courts - \$94,500
- Commission on Criminal and Juvenile Justice - \$50,000

Environmental Quality - The governor recommends \$0.2 million in one-time funds to support her watershed initiative. This will match a federal fund appropriation Senator Bennett obtained to assist in this effort. Communities throughout the state have adopted watersheds and worked on projects to stabilize stream banks and improve the quality of water in those areas.

Figure 4
SALARY COMPRESSION
 Employee Salaries by Quartile



Economic Development

Governor Walker has recommended a \$5.0 million appropriation to the Department of Community and Economic Development to support programs at Hill Air Force Base (HAFB). A commitment of state funds to purchase equipment and software and to provide training for new programs at HAFB will bring 125 to 1,425 new high-paying jobs to the state. In addition, it will strengthen HAFB's viability for continued operation.

Compensation

State employee pay continues to fall further behind market levels. State employees have been given a total of 1.1 percent in salary increases over the last three years. For this three year period, inflation was 5.1 percent. The Central States Compensation Association has ranked Utah 24th out of 25 states for employee salary increases. The

average actual salary paid to state employees has dropped to 19.9 percent below market, the furthest behind it has ever been.

In the past, benefits provided to state employees were significantly richer than market. However, as benefit costs have increased and benefits have been scaled back, the state's benefit package has lost its market advantage, and is now only 1.2 percent above the market. When adding the employees' salaries at 19.9 percent below market and benefits at 1.2 percent above market, the employees' compensation is 18.7 percent below market. Benefits are no longer a key advantage in employee attraction and retention.

Governor Walker recognizes the important role employees play in delivering government services, and the need to compensate them fairly for their work. The governor recommends a 3.0 percent cost-of-living adjustment (COLA) for state employees. She also recommends the state cover the

increases in the health and dental insurance premiums of 11.8 percent and 6.0 percent, respectively. These salary and benefit increases require \$24.2 million for state employees alone. In addition, increases for public and higher education are tied to comparable increases for state employees. These combined increases equate to \$78.6 million for public education teachers and staff in the form of a 5.0 percent increase in the WPU. As discussed previously, the governor also recommends that higher education receive a \$24 million block grant to retain key faculty and staff, and to meet compensation and benefits needs.

Industry compensation standards show that employees in the private sector can expect to be at midpoint within three to five years. The majority of state employees' salaries are below the midpoint of their salary range, even though many of these employees have worked ten or more years for the state. This salary compression problem, as shown in Figure 4, often results in new employees' starting salary being the same as employees with years of experience. In essence, the state is paying training wages to its employees.

The governor is recommending the following market comparability adjustments to move actual average salaries closer to market salaries.

- Employees 15-25 percent below market receive one step, a 2.75 percent increase
- Employees 25-35 percent below market receive two steps, a 5.5 percent increase
- Employees 35-45 percent below market receive three steps, an 8.25 percent increase
- Employees more than 45 percent below market receive four steps, an 11 percent increase

Of the state's approximately 20,900 full-time equivalent positions, 66.2 percent will receive market comparability adjustments. The governor wants to begin the process of moving employees through their salary ranges, thereby reducing the compression problem.

Capital Projects

Prior to the economic downturn, the state used cash appropriations for a large portion of its building needs. This source of financing was replaced with debt when revenues declined. In addition, a number of projects were delayed. Governor Walker recommends the use of \$100 million of one-time money to finance the construction of eight state-owned buildings.

PAY-AS-YOU-GO CAPITAL PROJECTS

U of U's Marriott Library	\$48,488,000
UVSC's digital learning center*	18,857,000
Corrections' 288 bed facility	13,330,000
UBATC and USU's Vernal campus	10,788,000
Richfield Regional Center	5,043,000
Human Services' Developmental Center housing	2,575,000
Natural Resources' Fire Management Service facility	694,000
Courts' Provo land purchase	225,000
	\$100,000,000

** The governor also recommends \$18.9 million in general obligation bonds in FY 2006 for the center.*

In FY 2006 the state will pay off \$137.1 million of general obligation bonds. Governor Walker is proposing \$223.9 million in general obligation bonds consisting of \$70 million for highways and \$153.9 million for capital facilities. The \$153.9 million for capital facilities includes \$135 million of general obligation bond authorization for the completion of the Capitol renovation project. This will allow the Capitol Preservation Board to sign construction contracts for the completion of the project and potentially save the state money by locking in final completion prices early. Governor Walker recommends that only \$50 million of the \$135 million authorization be issued in FY 2006. The governor also recommends that \$7.9 million of lease revenue bonds be issued by the State Building Ownership Authority to construct three new Alcoholic Beverage Control stores.

Fiscal Management

Revenue Forecasts – Utah closed out FY 2004 with a \$95.5 million surplus, marking the beginning of an economic recovery for state revenues. The Governor's Office of Planning and Budget, the Tax Commission, and the Office of the Legislative Fiscal Analyst reached consensus on the revised revenue estimates used for FY 2005 and new revenues for FY 2006. Revised revenue forecasts for the General Fund and Uniform School Fund for FY 2005 are \$180.8 million more than authorized. The FY 2006 budget revenue estimate is \$370.3 million more than the FY 2005 authorized amount. It is typical for revenue forecasts to lag behind actual revenue collections at this turning point in the economic recovery.

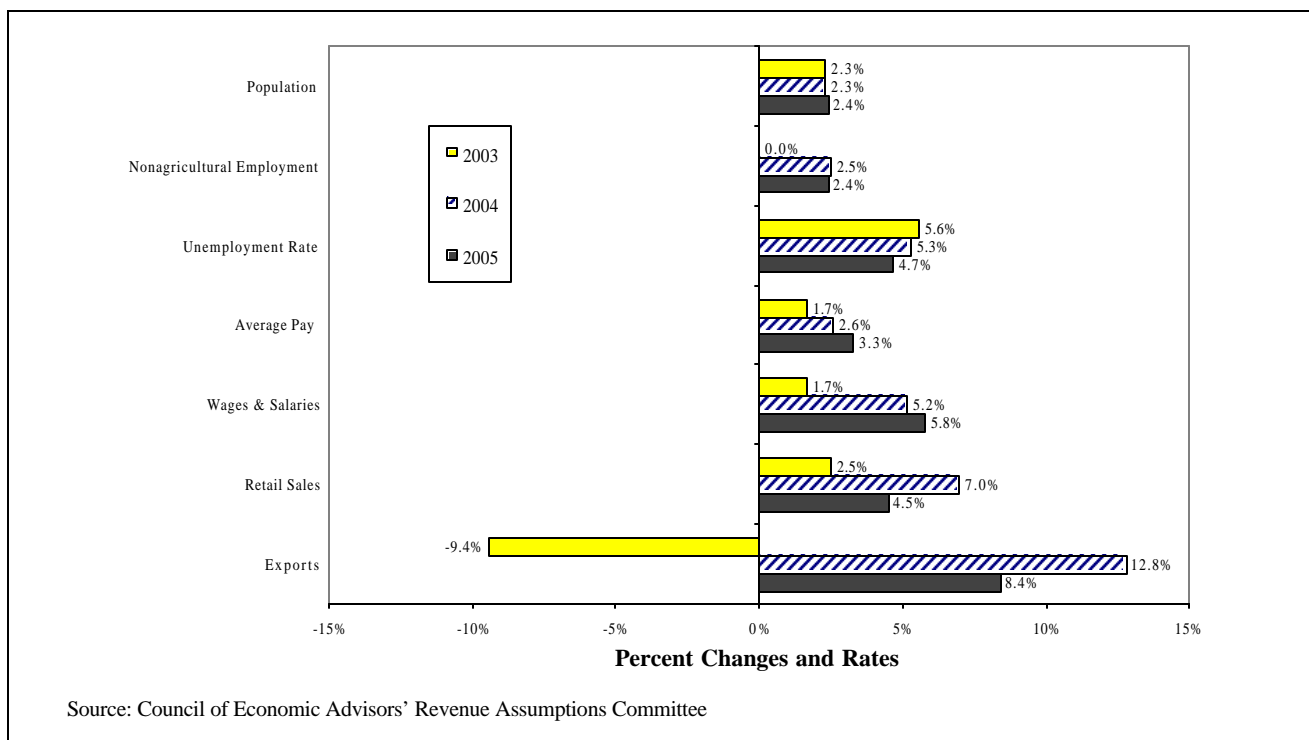
The Council of Economic Advisors provides input and reviews the basic assumptions that lead to the governor's revenue forecasts. Members of the council represent the Governor's Office of Planning

and Budget, the Office of the Legislative Fiscal Analyst, Wells Fargo Bank, Federal Reserve Bank of San Francisco, Utah Foundation, University of Utah, Utah State University, Brigham Young University, and various state agencies. Detailed information concerning Utah's economy and its outlook may be found in the *2005 Economic Report to the Governor* (available January 2005).

Economic Forecasts – Utah's economy continues to improve as it recovers from the recent economic downturn. Current expectations of the economic community are that growth will continue at a moderate rate during 2005. Service industries will remain the largest source of new jobs in the state. Figure 5 shows projected growth in economic indicators for Utah. It also shows estimated unemployment rates. The following data are for the calendar years indicated:

- **Population** — The current state population is estimated at 2.5 million and is forecasted to

Figure 5
UTAH ECONOMIC INDICATORS



grow by 2.4 percent in 2005, while the U.S. population is projected to grow at a rate of 0.9 percent. Utah experienced net in-migration of about 18,400 people in 2004 and expects net in-migration of about 22,000 people in 2005.

- **Employment** — Utah employment experienced flat growth in 2003, but is expected to increase 2.5 percent in 2004 and 2.4 percent in 2005. Meanwhile, the national employment growth rate is expected to increase by 1.7 percent in 2005. The state's 2005 unemployment rate is projected at 4.7 percent, compared to 5.4 percent nationally.
- **Personal Income** — Utahns' personal income growth is expected to be higher than the national average in 2005. State personal income grew 2.8 percent in 2003 and is projected to grow 4.9 percent in 2004 and 5.7 percent in 2005. Nationally, personal income is forecasted to grow 5.2 percent in 2004 and 4.9 percent in 2005.
- **Retail Sales** — The retail sales growth rate is expected to decrease slightly from 7.0 percent in 2004 to 4.5 percent in 2005. Nationally, the growth rate is forecasted to increase 7.0 percent in 2004 and by 3.3 percent in 2005.

Reserve Funds – For FY 2005 Governor Walker recommends \$47 million be deposited into the Rainy Day Fund and \$25 million into the Education Budget Reserve Fund, a total of \$72 million. In 1986, House Bill 13, *Surplus Revenue Trust Fund* (Walker, O.), created the Rainy Day Fund within the General Fund to help stabilize the state's budget against revenue shortfalls. These funds can only be used to cover operating deficits, retroactive tax refunds, and settlement agreements approved by the legislature. State law requires that fund interest earnings and 25 percent of any General Fund surplus be transferred to the Rainy Day Fund. In addition, another 25 percent of any General Fund surplus must be transferred to the Rainy Day Fund until the fund has replenished the FY 2002 reductions. The balance in the Rainy Day Fund at the end of FY 2004 was \$53.6 million.

In 2003, House Bill 27, *Budget Reserve Account Amendments* (Buttars, Craig), created the Education Budget Reserve Fund within the Uniform School Fund. The Education Budget Reserve Fund is a reserve to cover operating deficits in the public and higher education systems. The fund is to receive 25 percent of any surplus in the Uniform School Fund at the end of each fiscal year. The new Education Budget Reserve Fund had a balance of \$13.3 million at the end of FY 2004.

The total amount that may be held in the Rainy Day Fund and the Education Budget Reserve Fund may not exceed 6.0 percent of the combined total of appropriations for all purposes from the General Fund and the Uniform School Fund. The ceiling for the combined funds was \$214.4 million at FY 2004 year end. The governor's recommendations bring the funds' combined balance to \$146.1 million.

Appropriations Limit – Section 63-38c-201 through 205, UCA, limits how much the state can spend from the General Fund and from non-Uniform School Fund income tax. The limit allows state spending to increase only as population and inflation increase. The governor's recommendations for FY 2005 and FY 2006 are within the limit.

FY 2005 and FY 2006 Challenges

With a significantly improved economy, the FY 2005 budget remains in balance. The revised revenue estimate for FY 2005 allows the use of one-time monies to pay for capital development projects and to replenish the budget reserve funds. The FY 2006 budget has considerably more revenue available, but still not enough to meet all of the demands for services. This pressure will continue due to increases in: public and higher education enrollment, Medicaid caseload, employee compensation and health insurance, food stamp eligibility, inmate population, and the high-risk health insurance pool. The governor's recommended increases are shown in the following: (1) Table 1 in summary form, (2) Tables 6 and 7 by department, and (3) the tables in the Recommendations by Department section in detail.



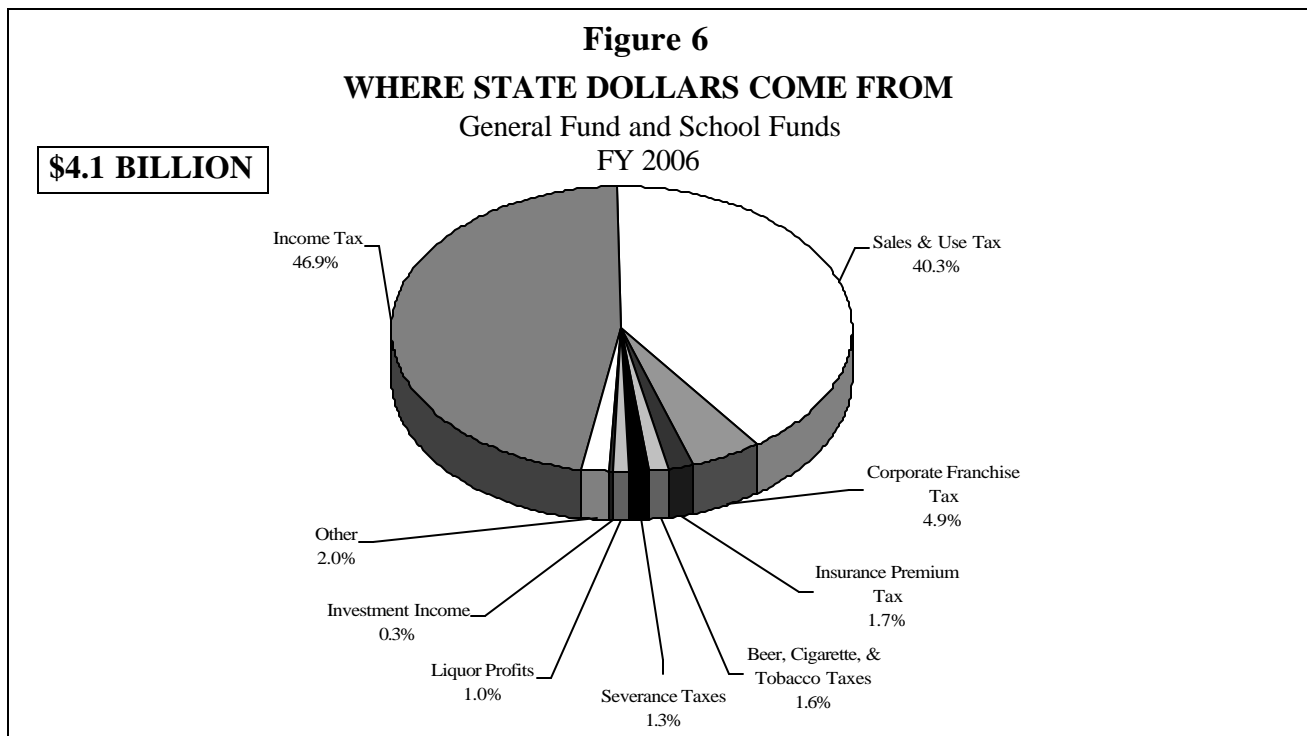


Figure 6 shows the estimated sources of state revenue (General Fund and school funds) for FY 2006.

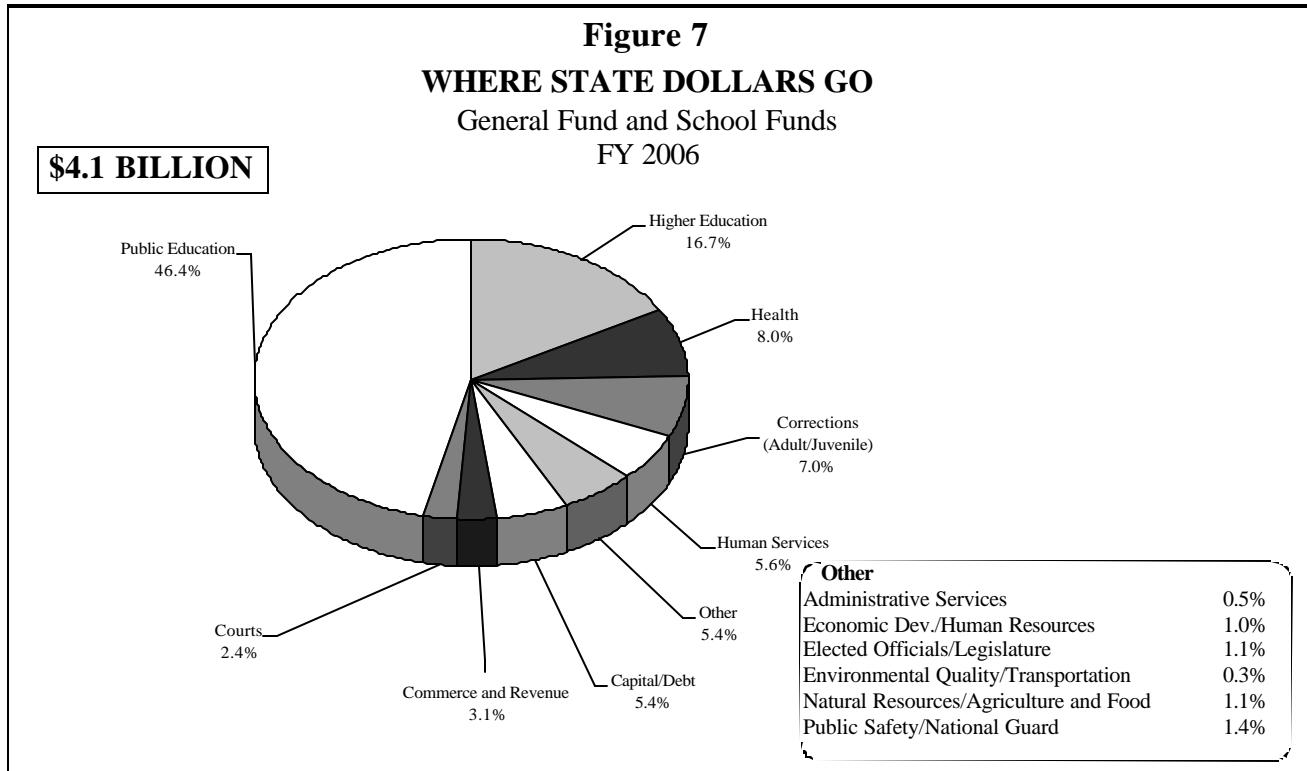


Figure 7 shows how state funds (General Fund and school funds) will be expended in FY 2006. The largest portion, amounting to 63.1 percent, goes to Public and Higher Education.

Figure 8
WHERE ALL FUNDS COME FROM

All Sources of Funding
FY 2006

\$8.6 BILLION

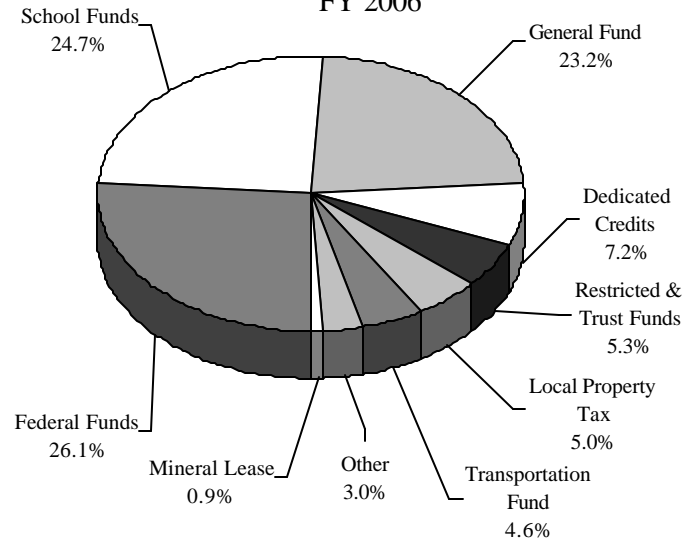


Figure 8 shows the total estimated sources of revenue for the FY 2006 budget. The General Fund and school funds, consisting primarily of sales and income taxes respectively, generate just under one-half (47.9 percent) of the total state budget.

Figure 9
WHERE ALL FUNDS GO

All Sources of Funding
FY 2006

\$8.6 BILLION

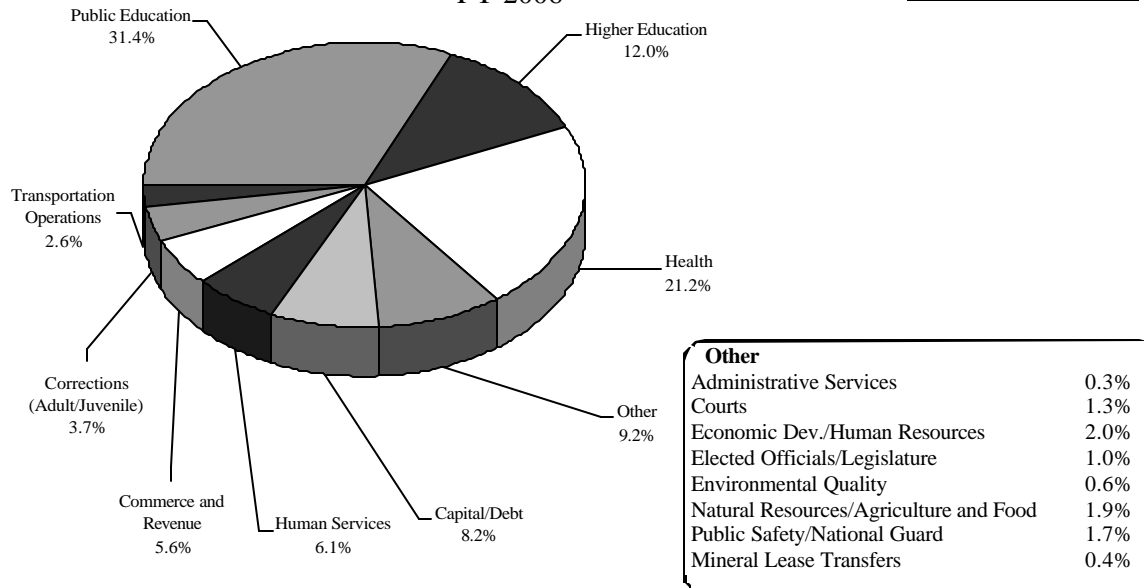


Figure 9 shows total state budget expenditures for FY 2006 from all sources of funding. Public and Higher Education receive nearly half of total state resources.